South Coast AQMD
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New Internal Bank Offsets for Post-RECLAM Large NOx Facilities

The District has proposed potentially "seeding" a new internal bank for over 4-tons per year sources of NOx by taking or at least borrowing some offsets from its existing bank maintained under Rule 1315. EPA staff has suggested they may need to examine the individual offsets that went into the internal bank (in a similar fashion to what was done with offsets provided to Sentinel). This is incorrect for two reasons. First, EPA does not need to investigate the validity of individual offsets deposited into the District's internal bank under Rule 1315, because it has approved the methodology for ensuring that such offsets meet the federal integrity requirements. Second, the Sentinel offsets were not accounted for under the Rule 1315 integrity elements but rather under a separate process whereby offsets from particular sources removed from the bank and then were examined individually. It is neither possible nor necessary to use the same methodology to examine offsets tracked and deposited in the Rule 1315 bank. The validity of such offsets may be challenged at the time of deposit, but only by challenging whether the District properly applied the SIP-approved Rule 1315 integrity criteria, not by seeking to apply a different method of establishing the integrity criteria.

In 2012, EPA approved the District's Rule 1315 into the state implementation plan. 77 Fed. Reg. 31,200 (May 25, 2012). As EPA stated in its proposed approval, EPA found that Rule 1315 provides an adequate system to demonstrate that an equivalent amount of offsets are being provided as would otherwise be required by the CAA, and that the emissions reductions the District is crediting and debiting in its offset accounts meet the requirements of the CAA. 77 Fed. Reg. 10,430 (Feb. 22, 2012). Therefore, as EPA explained in its brief in opposition to a subsequent challenge brought by certain environmental groups, the Rule 1315 "SIP Revision ensures that the emission reduction credits and debits it tracks meet federal integrity criteria…." Respondent's Brief, p. 1.

Indeed, a key issue in the appeal was whether EPA was required to examine each offset deposited into the bank, or only to approve the SIP mechanism which ensured that such offsets meet the integrity requirements. As EPA explained, just as with other New Source Review SIP provisions, "EPA reviews and approves the rules governing the overall conduct of such programs by the States indefinitely into the future, but does not pass judgment on individual transactions which these programs share.", *citing* 54 Fed. Reg. at 27,294 n. 8. (Resp. Br., p. 24.)

However, EPA does maintain the ability to provide oversight over the District's Rule 1315 program. Each year, the District provides a "Federal NSR Equivalency Determination Report" (Rule 1315(d)) which accounts for the debits from and credits to the offsets account, and ensures that the account balance remains positive for each pollutant, and is projected to remain positive for the next two future accounting periods. (Rule 1315(e)). Thus, EPA is assured that the appropriate offsets and offset ratios are satisfied. If EPA-or anyone else-wants to see the detailed information regarding offsets deposited into the bank that year—source of reductions, proper qualification under rule 1315(c)(3), and calculation of 80% of emissions potential where

applicable (Rule 1315(c)(3)(B)), the District can provide the necessary records to evaluate whether the rule was followed. Similarly, for each year, the District can provide the information upon which it based its adjustment to ensure the offsets remain "surplus at time of use." (Rule 1315(c)(4).) Therefore, the validity of individual offsets can be checked or challenged at the time they are quantified and deposited into the bank, but using the quantification methodology set out in Rule 1315, not the methodology used for the Sentinel project.

When EPA approved the SIP revision providing offsets to the Sentinel power plant project, certain environmental groups sued, arguing that offsets provided on behalf of Sentinel could only be provided pursuant to Rule 1315. EPA explained, and the Ninth Circuit agreed, that the Sentinel SIP revision provided a separate alternative path to obtaining offsets as a source-specific SIP revision for the Sentinel project, and did not have to follow Rule 1315 methodology. Instead of using Rule 1315, which was not yet SIP approved, the District transferred certain specific offsets representing specific facility shutdowns or emission reduction projects and evaluated each offset to ensure it individually met the federal integrity criteria.

The Sentinel SIP revision represented a collection of individual offsets that were individually evaluated, rather than evaluated according to a specified tracking system which tracks reductions in the aggregate. For example, the offsets in the internal bank under Rule 1315 are reduced each year to ensure they as a whole remain surplus at the time of use. But the offsets in the Sentinel SIP revision were evaluated individually to ensure they were surplus. Accordingly, in approving the Sentinel source-specific SIP revision, EPA likewise evaluated the individual offsets. (Resp. Br., p. 29.)

Significantly, the individual offsets that were removed from the internal accounts and supplied on behalf of Sentinel represented the large majority of offsets for which the District had individual emission reports establishing actual emissions for the two-year period immediately preceding the shutdown. The lack of such reports for other sources (smaller sources) required the District to set forth a surrogate for actual emissions in establishing its Rule 1315 methodology, which EPA approved. Therefore, it would not be feasible or appropriate to use the Sentinel methodology to evaluate offsets deposited in the Rule 1315 internal bank. If any method is used, it must be the method set forth in Rule 1315.

EPA indicated in its Respondent's Brief p. 23 that the validity of the offsets could be challenged at the time they are used for a particular permit, but this is not strictly accurate because when a particular permit receives offsets from the bank, it only receives a specific amount of offsets, not offsets from a particular source. Thus, it is possible to ensure that the permit is supported by the proper amount of offsets from the internal bank, but the validity of the credits deposited into the bank must be assessed at the time they are deposited, or within the applicable statute of limitations.

This is no different from the situation with an emission reduction credit the District issues to a private party under Rule 1309. Rule 1309(b)(4) establishes that each ERC is evaluated to ensure that it meets the federal integrity criteria. Upon approval by the District, the applicant receives a certificate of registration of its ERC. (Rule 1309(c).) Whether the ERC meets the rule criteria can be challenged upon issuance or within the applicable statute of limitations. A permit applicant must provide sufficient ERCs to meet the applicable offset requirements. (Rule 1303(b)(2).) At the time a permit is issued, a person could challenge whether sufficient offsets

had been supplied, but could not challenge the validity of an individual offset unless it was within the applicable statute of limitations.

In the case of the internal bank, if a person were to successfully show that a given deposit did not meet all EPA requirements, then the balance in the bank would have to be adjusted by the amount corresponding to the difference between what was deposited and the amount, if any, that should have been deposited. However, assuming the account balance remained positive, an individual permit could not be challenged on this basis.